No. 10084

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

CALIFORNIA CENTURY COMPANY, a California Corporation, and RAYMOND LEWIS, doing business as Lewis Construction Company,

Appellants,

vs.

SECURITY-FIRST NATIONAL BANK OF LOS ANGELES, a national banking association,

Appellee.

APPEAL BRIEF OF APPELLEE SECURITY-FIRST NATIONAL BANK OF LOS ANGELES.

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Appellants contend that it is the duty of the Bankruptcy Court to determine and adjudicate adverse claims to property in its possession, and also that where the Bankruptcy Court gives its permission for the trial of an action elsewhere, the action must be tried in a State Court unless the United States District Court would have had jurisdiction in an action between the parties had there been no bankruptcy. We submit that it was the

Bankruptcy Court which tried this case. As alleged in the complaint [Clk. Tr. p. 19] the petition for adjudication in bankruptcy of the defendant, Raymond Lewis, doing business as Lewis Construction Company, was filed in the District Court of the United States, Southern District of California, Central Division, and defendant Paul W. Sampsell had possession of the certificates of stock constituting the subject matter of this suit as receiver in said proceedings. After consent of the Referee in Bankruptcy had been obtained [Court's Transcript p. 7], this suit was instituted in the same court. It was brought, therefore, in the court which was in possession of the certificates of stock constituting the subject matter of the controversy. It was brought in the District Court of the United States, Southern District of California, Central Division, which was the Bankruptcy Court. It is appellee's contention that as the *res* was in the possession of that court, it therefore had exclusive jurisdiction to hear and determine this cause. To such cases, the provisions of Section 23a of the Bankruptcy Act are not applicable.

POINT I.

Where a Court of Competent Jurisdiction Has Taken Property Into Its Possession, the Property Is Thereby Withdrawn From the Jurisdiction of All Other Courts.

In the case of *Wabash Railroad v. Adelbert College*, 208 U. S. 38 on page 46, the Supreme Court stated:

> "It appears from this statement that the railroad property affected by this controversy was in the actual possession, through receivers, of Circuit Courts of the United States from the date of the appointment of receivers, May 27, 1884, to the date of their discharge and the delivery of the property to the purchasing committee, which was ordered on June 18, 1889, and accomplished about July 1, 1889. It cannot be and apparently is not disputed that, during that period, the property was in the possession of the Circuit Courts of the United States, and that that possession carried with it the exclusive jurisdiction to determine all judicial questions concerning the property."

On page 54 the court stated:

> "When a court of competent jurisdiction has, by appropriate proceedings, taken property into its possession through its officers, the property is thereby withdrawn from the jurisdiction of all other courts. The latter courts, though of concurrent jurisdiction, are without power to render any judgment which invades or disturbs the possession of the property while it is in the custody of the court which has seized it.

> For the purpose of avoiding injustice which otherwise might result, a court during the continuance of its possession has, as incident thereto and as ancillary to the suit in which the possession was acquired, jurisdiction to hear and determine all questions respecting the title, the possession or the control of the property. In the courts of the United States this incidental and ancillary jurisdiction exists, although in the subordinate suit there is no jurisdiction arising out of diversity of citizenship or the nature of the controversy. Those principles are of general application and are not peculiar to the relations of the courts of the United States to the courts of the States; . . ."

In the case of *Irving Trust Co. v. Fleming,* reported in October, 1934, in 73 Federal Reporter (2d) 423, the Circuit Court of Appeals, Fourth Circuit, stated on page 427:

> "Since, therefore, the District Court for the Southern District of New York, through its trustee in bankruptcy, was in possession of the property in controversy, we think that that court alone had jurisdiction to determine rights in and claims against that property, and that no other court had any right to interfere with its possession. As said by Mr. Justice Brandies, speaking for the Supreme Court of the United States in the recent case of *Ex parte* Baldwin, 291 U. S. 610, 54 S. Ct. 551, 553, 78 L. Ed. 1020: 'The power is not peculiar to bankruptcy or to the federal courts. It is an application of the general principle that, where a court of competent jurisdiction has, through its officers, taken property into its possession, the property is thereby withdrawn from the jurisdiction of other courts.

> Having possession, the court may not only issue all writs necessary to protect its possession from physical interference, but is entitled to determine all questions respecting the same. Julian v. Central Trust Co., 193 U. S. 93, 112, 24 S. Ct. 399, 48 L. Ed. 629; compare Riehle v. Margolies, 279 U. S. 218, 223, 49 S. Ct. 310, 73 L. Ed. 669; Straton v. New, 283 U. S. 319, 51 S. Ct. 465, 75 L. Ed. 1060. . . .'"

In the case of *Gross v. Irving Trust Company,* 289 U. S. 342, 77 L. Ed. 1243, on page 344, the Supreme Court states:

> "In Buck v. Colbath, 3 Wall. 334, 341, the rule is stated to be that 'whenever property has been seized by an officer of the court, by virtue of its process, the property is to be considered as in the custody of the court, and under its control for the time being: and that no other court has a right to interfere with that possession, unless it be some court which may have a direct supervisory control over the court whose process has first taken possession, or superior jurisdiction in the premises.'"

In view of the fact that the bankruptcy proceedings were pending in the same court which tried this case. appellant's argument that it was the duty of the Bankruptcy Court to determine and adjudicate the adverse claim to the property in its possession, must be limited to the question of whether the controversy should have been heard in a summary proceeding rather than with formal pleadings.

POINT II.

Where the Bankruptcy Court Has the Necessary Possession of the Property in Controversy, the Fact That an Adverse Claimant Chooses With the Consent of the Referee in Bankruptcy to Seek Determination of the Rights of the Parties in a Formal, Plenary Manner in That Court, Rather Than by Summary Procedure, Will Not Defeat the Court's Jurisdiction.

In the case of *Whitney v. Wenman,* 198 U. S. 539, the sole question was one of jurisdiction, raised when a demurrer to the bill had been sustained in the District Court on the ground that the court had no jurisdiction. On page 553 the court stated:

> "Nor can we perceive that it makes any difference that the jurisdiction is not sought to be asserted in a summary proceeding, but resort is had to an action in the nature of a plenary suit, wherein the parties can be fully heard after the due course of equitable procedure.
>
> . . . . . .
>
> ". . . The court had possession of the property and jurisdiction to hear and determine the interests of those claiming a lien or ownership thereof. . . . Whether the rights of the claimants to the property could be litigated by summary proceedings, we need not determine. What we hold is that under the allegations of this bill the District Court had the right in a proceeding in the nature of a plenary action, in which the parties were duly served and brought into court, to determine their rights, and to grant full relief in the premises if the allegations of the bill shall be sustained. This view renders it unnecessary to consider the effect of the amendments of the bank-

ruptcy act, passed February 5, 1903, broadening the power of the bankruptcy courts to entertain suits by trustees to set aside certain conveyances made by the bankrupt."

In the case of *First Savings Bank & Trust Co. of Albuquerque, N. M., et al. v. Butler,* 282 Federal 866, the Circuit Court of Appeals, Eighth Circuit, stated on page 868:

"True, as all of those holding provable demands scheduled by the bankrupt against his estate in bankruptcy, whether preferential or general in their nature, by operation of law became parties to the bankruptcy proceeding, the trustee on his appointment and qualification could have moved in the bankruptcy proceeding for the relief granted him in this suit, and such course would have been much less cumbersome, expensive, and dilatory than the course adopted.

"However, this goes, not to the merits of the case, but merely to the manner in which the relief demanded should be invoked. There is no question of that comity arising between courts of concurrent jurisdiction in this case. Nor is the question of jurisdiction dependent upon the citizenship of the parties. Under the Constitution the jurisdiction of a court of bankruptcy in administering the estates of bankrupts under the provisions of the Bankruptcy Act is complete and exclusive, and it is not only the right, but the duty, of such courts to draw unto themselves all the property of the bankrupt estate and the determination of all claims and demands existing against the same, to the end that there may be an orderly and complete determination and settlement of the entire estate among creditors."

In the case of *Rockmore v. New Jersey Fidelity and Plate Glass Ins. Co. et al.,* 65 Federal Reports (2d) 341, the Circuit Court of Appeals, Second Circuit, stated on page 342:

> "A bankruptcy court may adjudicate conflicting rights to property in the actual or constructive possession of the trustee, either in a summary proceeding or in a suit brought in the United States District Court. While such conflicting rights are ordinarily adjudicated in the bankruptcy proceeding itself, the form of the remedy is not important."

Of the authorities cited by the appellants, the case of *U. S. Fidelity Co. v. Bray,* 225 U. S. 205, is the only one which appears to support his contention. We wish to point out that in that case the District Court (which was the Bankruptcy Court) entered an order giving leave to file the bill in the Circuit Court. It was not the Bankruptcy Court, therefore, which heard and determined that controversy. But in the case presented on this appeal, it was the Bankruptcy Court which heard and determined the controversy.

Appellants' second point is that the court erred in finding that California Century Company rendered itself insolvent by virtue of its transfer of shares of the Amusement Enterprises, Inc., to Raymond Lewis. They argue that the expert witness, Robert Baker, testified as to the value of the real property owned by the defendant, California Century Company, as of the 9th day of January, 1939 and that the value should have been proved as of

the 11th day of January, 1939 or some date subsequent thereto. As there was no evidence that the property was of a highly speculative nature, this contention has no merit especially since the income from the property was limited by a lease. Furthermore, there was ample other evidence, which we shall quote, to support the finding of insolvency. But before quoting this evidence, we wish to point out that as the court found that the transfer was made with the intent to defraud creditors and that the transferee knew at the time that it was made for that purpose, a finding on the insolvency of the transferror is not necessary to support the judgment.

Finding No. XVII, on page 23 of the transcript, reads as follows:

> "That the said transfer of said shares of stock in Amusement Enterprises, Inc. to defendant, Raymond Lewis, doing business as Lewis Construction Company, was voluntary and was made for the purpose of defrauding creditors of defendant, California Century Company; that defendant, Raymond Lewis, doing business as Lewis (20) Construction Company, knew the facts pertaining to said transfer, knew at the time of said transfer that defendant, California Century Company, would be rendered insolvent by said transaction, knew that said transfer was being made for the purpose of defrauding creditors of California Century Company."

POINT III.

Where a Transfer Is Made With Intent to Delay and Defraud Creditors, a Fnding That the Transferror Was Insolvent at the Time of the Transfer or Was Rendered Insolvent Thereby, Is Not Necessary to Support a Decree Setting Aside the Transfer as Fraudulent as Against Creditors.

At the time of the transfer Section 3439 of the California Civil Code read as follows:

> "Every transfer of property or charge thereon made, every obligation incurred, and every judicial proceeding taken, with intent to delay or defraud any creditor or other person of his demands, is void against all creditors of the debtor, and their successors in interest, and against any person upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor."

In *Benson v. Harriman,* 55 Cal. App. 483, 275 Pac. 984, on page 485 of the official reports, the court states:

> "Moreover, the rule in this state is that if a conveyance is made with intent to defraud creditors, it is void, notwithstanding the debtor has other property ample in amount to satisfy his creditors. Bekins v. Dieterle, 5 Cal. App. 690, 91 Pac. 173; Slade Lumber Co. v. Derby, 31 Cal. App. 155, 159 Pac. 881; Johns v. Baender, 40 Cal. App. 790, 182 Pac. 55; First National Bank of L. A. v. Maxwell, 123 Cal. 360, 55 Pac. 980, 69 Am. St. Rep. 64."

In *Vogel v. Sheridan,* 4 Cal. App. (2d) 298, 40 Pac. (2d) 946, on page 305 of the official reports, the court stated:

> "This action, however, may be sustained under section 3439 of the Civil Code regardless of the ques-

tion of solvency as the evidence was sufficient to show an actual intent to delay and defraud creditors. Such intent invalidates the transaction as against creditors even though the debtor is not entirely stripped of assets and may still have sufficient property after such transfers to satisfy his creditors. Title Insurance, etc., Co. v. California Dev. Co., 171 Cal. 173, 152 P. 542; First National Bank of L. A. v. Maxwell, 123 Cal. 360, 55 P. 980, 69 Am. St. Rep. 64; Alpha H. & S. Co. v. Ruby Mines Co., 97 Cal. App. 508, 275 P. 984; Benson v. Harriman, 55 Cal. App. 483, 204 P. 255; Johns v. Baender, 40 Cal. App. 790, 182 P. 55; Bekins v. Dietreric, 5 Cal. App. 690, 91 P. 173; 12 Cal. Jur. pp. 976, 977. It is only in actions maintained under the proviso in section 3442 that the insolvency of the transferror becomes of controlling importance, and in such actions, the question of actual intent becomes immaterial."

In the case of *Adams v. Bell,* 5 Cal. (2d) 697 on page 701, the California Supreme Court stated:

> "Where an actual intent to defraud is satisfactorily shown, the conveyance may be set aside even though the debtor has not entirely stripped himself of assets. (Vogel v. Sheridan, *supra* [182 Pac. 55]; Benson v. Harriman, 55 Cal. App. 483 [204 Pac. 255]; Tobias v. Adams, 201 Cal. 689, 695 [258 Pac. 588]; Foss v. Wotton, *supra.*)"

Although a finding that California Century Company was rendered insolvent by the transfer was not necessary to support the judgment, such a finding was amply supported by the evidence. The evidence proved not only that by the transfer the company's assets were reduced far below its liabilities, but also that the company was not able to pay its debts from its own means as they became due.

POINT IV.

A Debtor Is Insolvent When He Is Unable to Pay His Debts From His Own Means as They Become Due.

Section 3450 of the California Civil Code provides:

> "A debtor is insolvent, within the meaning of this title, when he unable to pay his debts from his own means, as they become due."

In the case of *Alpha H. & S. Co. v. Ruby Mines Co.,* 97 Cal. App. 508, 275 Pac. 984, the court stated, on page 515, official reports:

> "The evidence on the part of respondent was that, while the value of the property owned by the company exceeded the amount named in the note and deed of trust, at and prior to the date of the execution of the said note and deed of trust, the company was unable to pay its debts as they became due; that as a matter of fact the note and deed of trust were executed to prevent the creditors of the company, where debts were due and unpaid, from enforcing the collection thereof by attachment. A debtor is insolvent when he is unable to pay his debts from his own means as they become due."

Southwick v. Moore, 61 Cal. App. 585, 215 P. 704;

First National Bank of Los Angeles v. Maxwell, 123 Cal. 360, 55 P. 980, 69 Am. St. Rep. 64.

In *Dixon Lumber Co. v. Peacock,* 217 Cal. 415, 19 Pac. (2d) 233, the California Supreme Court stated:

> "A writ of execution returned *nulla bona,* at least in the county of the judgment debtor's residence, makes out a *prima facie* showing of insolvency. We

> think it unnecessary to determine whether an execution so returned by the sheriff of a county from which the judgment debtor had lately moved his residence, is sufficient to make out such a case for the reason that there is some independent evidence contained in the letter of Peacock and the efforts of respondent to collect to support the conclusion that the judgment debtor was unable to pay his debts when they became due. It is said in *In re* Ramazzina, 110 Cal. 488 (42 Pac. 970): 'A debtor when he is unable to pay his debts from his own means, as they become due is insolvent.' (Washburn v. Huntington, 78 Cal. 573 [21 Pac. 305]; Sacry v. Lobree, 84 Cal. 41 [23 Pac. 1088].)"

On page 59 of the clerk's transcript is schedule B of the bankruptcy statement filed by Raymond Lewis, defendant and appellant. In the schedule he listed the 268,132 shares of capital stock of Amusement Enterprises, Inc. which he received in the transfer herein complained of as worth $536,264.00 and 2500 shares of stock of California Century Company (the entire issue of capital stock of the company) "no value." His signed and sworn statement therefore is virtually an admission that after the California Century Company transferred the stock of Amusement Enterprises, Inc. to himself, the company was insolvent. Its entire issue of stock was valueless.

Turning to page 72 of the transcript we find that this appellant testified as follows:

> "Q. Now, after the transactions that you have mentioned, it left the California Century Company with the parking lot as its sole asset? A. The parking lot parcel, do you mean, Mr. Hart?

Q. Yes. A. Yes.

Q. What was the income of the California Century Company? A. $1250.00 a month.

Q. That was the only income that it had? A. I don't recall of any other income.

Q. Was that the rental on the lease of the parking lot? A. That is correct."

On page 75 of the transcript, Warrent V. Glass, assistant cashier of the Bank of America, testified as follows:

"Q. And pursuant to subpoena, do you have with you a note executed by the California Century Company to the Bank of America? A. I have.

. . . . . .

Q. I would like to ask you what were the installments on this note. A. $750.00 a month, plus interest beginning April 1st."

The note was introduced in evidence and set forth on pages 76 to 78 of the transcript. It reads in part on pages 76 and 77:

"$116,420.73

Los Angeles, California, October 6, 1938

For value received, California Century Company, a corporation, promises to pay in lawful money of the United States of America, to the order of the Bank of America (National Trust and Savings Association) at its Los Angeles Main Branch in this city the principal sum of One Hundred Sixteen Thousand Four Hundred Twenty and 73/100 Dollars, with interest payable monthly in like lawful money from April 1, 1938 on deferred balances until paid at the rate of five per cent per annum;

and said principal sum payable as follows: Seven Hundred Fifty and no/100 Dollars, ($750.00), on the first day of April 1938, and seven hundred fifty and no/100 Dollars, ($750.00), on the first day of each and every month thereafter until the 15th day of September, 1947, on which said date the entire balance of principal and interest then unpaid shall become due and payable."

The payments on the note are set forth on page 78 of the transcript and show that the payment due January 1, 1939 was $750.00 principal and $460.09 interest. The payment due February 1, 1939 was $750.00 principal and $456.75 interest. Installments due for many months thereafter are also set forth. These installments of principal and interest were in excess of $1,200.00 per month.

In addition to the monthly obligation in excess of $1,200.00 of California Century Company to Bank of America on the note, there were various taxes and bond assessments against the real property owned by the company.

These obligations were as follows:

On page 72 of the transcript James W. Howard, supervisor of the street bonds department of the City Treasury, testified:

"Q. Pursuant to subpoena out of this court have you produced the records of your office showing the opening and widening street bonds for improvement of Third Street, against the property located at the northeast corner of Third Street and Vermont Avenue, which would be the property set forth in Plaintiff's Exhibit 1 referred to as the parking lot parcel, and marked in blue pencil? A. Yes.

. . . . . .

Q. Well, will you—I will ask you this—what were the installments delinquent, if any, on that bond issue, in January, 1939? A. In January, 1939 there was one payment of principal $709.07 that was delinquent from July 1, 1938.

Q. Was there also interest on that? A. Interest of $1,042.32.

Q. Then the total delinquency was—A. $1,751.39.

Q. Was the installment on that bond that became due January 1, 1939 paid when due? A. No, that wasn't paid till September 14, 1939.

. . . . . .

Q. All right, will you go to the other bond? What was the unpaid principal balance on that bond in January, 1939? A. $3,890.95.

Q. Were there any delinquencies on that bond at that time, any delinquent installments? A. That is as of January, 1939. Is that right?

Q. That is right. A. The bond had been delinquent—that being a 10-year bond, it matured July 1, 1938, and as of January, 1939 it was delinquent on the principal payment from July 1, 1934, and the interest payment from July 1, 1937.

Q. Could you tell us approximately what the delinquencies amounted to in January, 1939, without too much computation? A. $4,054.31."

On page 68 of the transcript, Reginald J. Cromie, deputy county tax collector, testified:

"Q. Pursuant to subpoena issued by this court, have you produced a record showing the status of taxes against the property described in Plaintiff's

Exhibit 1, and marked with a blue pencil, being the property at the northeast corner of Vermont and Third shown on this plat? A. Yes, I have.

. . . . . .

Q. Will you give us the amount of the taxes? A. For the second installment, the one that went delinquent, the total amount of those was $1,544.79.

Q. By the Court: Now that item of $1,544.79 applied to what period of taxation? A. That was from January 1, 1939, to June 30, 1939.

Q. And you call that the second installment? A. Yes, our fiscal year is from July 1st to June 30th, and the second installment becomes due in January and takes up to June 30th of the same year."

In addition to these obligations there is the unsatisfied judgment of plaintiff against the California Century Company in the sum of $949.30 alleged in the complaint [Tr. p. 4] and admitted in the answer [Tr. p. 9], Finding No. VII [Tr. p. 20], on which execution had been returned by the marshal *"nulla bona"* [Finding VIII, Tr. p. 20].

From the above evidence it is apparent the debtor California Century Company did not have sufficient income to pay its obligations as they became due, and was therefore insolvent at the time of the fraudulent transfer. Furthermore there is no evidence in the record or referred to in the appellants' brief to support a contention that California Century Company was solvent, or even to overcome the *prima facie* case of insolvency made by Finding No. VIII that execution was returned *"nulla bona."* (*Dixon Lumber Co. v. Peacock*, 217 Cal. 415 (*supra*).)

Conclusion.

As the District Court, Southern District of California, Central Division, had actual possession of the certificates of stock which constitute the subject matter of this suit through its receiver in bankruptcy, that court had exclusive jurisdiction to determine this controversy.

Although there was ample evidence to support the finding of insolvency of the transferror, such a finding was not necessary to support the judgment since the court found also that the transfer was made with intent by both transferror and transferee to defraud creditors.

For the reasons stated, appellee Security-First National Bank of Los Angeles, asks that the judgment of the District Court be sustained and this appellee be reimbursed for its costs herein expended.

Respectfully submitted,

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